

**Finnish Institute of International Affairs (FIIA)
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THE OPTIONS FOR A TRUE ECONOMIC AND MONETARY UNION

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Scheme of the presentation

- **What do we need from a fiscal union?**
 - **Optimal vs. satisfying fiscal set-up**
 - **To complement monetary and banking union or wider?**
 - **The role of other mutualisation mechanisms**
 - **Control/direction of national budgets or federal budget?**
- **What do we have in terms of fiscal union?**
 - **Fiscal Compact, European Semester and all that**
 - **ESM**
 - **Eurosystem lending**
- **What is the gap between what we have and what we need and how do we fill it?**
 - **More control and guidance on national budgets?**
 - **Federal budget?**
 - **What about Eurobonds?**
 - **What about political feasibility?**
- **Conclusions**

What do we need from a fiscal union?

Maximization of general objectives

vs.

Damage avoidance

*“Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Union, as defined in Article 3 of the Treaty on European Union, and in the context of the **broad guidelines** referred to in Article 121(2)”*
(Art 120)

*“The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying **gross errors**”*

(Art 126)

Trade-off ?

Maximizing the wellbeing of
EU citizens

vs.

Pursuance of plausible
objectives

Most fruitful approach

Optimal vs. satisfying fiscal set-up

What do we need from a fiscal union?

Maastricht Treaty

Monetary Union
Fiscal Union
Banking union

vs.

Fully fledged fiscal union

Fiscal objectives: efficiency
stability
equity

Objectives of fiscal union:

- Avoiding national budgetary mistakes (risk reduction) → Negative spillovers from national budgetary policies
- Mutualisation of idiosyncratic shocks (risk sharing) → Offsetting tool alternative to FX
- Providing “ultima ratio” back stops for the consequences of banking union → Backstop of last resort for undercapitalized banks

To complement monetary and banking union or wider?

What do we need from a fiscal union?

1. Financial and Credit Market Integration

Doom loop between banks and sovereign.

Banking Union will contribute to better offset idiosyncratic shocks; However, banking union is not there as yet and its contribution **should not be exaggerated**.

2. Migration Flows

Mobility of natives vs. non-natives.

Mutualisation from migration and financial integration is significant *but* not large

3. Overall we need a stabilizing fiscal set-up

What do we need from a fiscal union?

Creating federal budget

- Unemployment, corporate taxes shifted to euro-area level;
- Support scheme based on deviations from potential output;
- CSI (Cyclical Shock Insurance mechanism)

vs.

Disciplining national budgets

- Jointly guaranteed borrowing
- Gradual withdrawal of fiscal sovereignty
- GDP indexed government bond issues
- €-area Minister of Finance

“ we believe that creating stringent state-level debt brakes in Europe without a capacity for countercyclical stabilisation [at federal level] would be a serious mistake”

[Henning, Kessler; 2012]

Effectiveness vs. Political realism trade-off Directives vs. Regulations

“states in the US can abide by strict budget balance rules to the extent the federal government is responsible for stabilisation and the bail-out of insolvent banks, but this simple lesson is sometimes overlooked in European discussions”.

[Pisani-Ferry; 2013]

What do we have in terms of fiscal union?

EU Economic Governance Regime	
1998/1999	Stability and Growth Pact
Preventive / Corrective Arm: Surveillance of budgetary and economic policies; Excessive deficit procedure	
2010	European Semester
Synchronizing the economic and fiscal reporting calendars; Changing the ex-post coordination to ex-ante; Dealing with the prevention part of the <i>MIP</i>	
March 2011	Euro Plus Pact
Coordination of fiscal policies through structural dialog	
December 2011	"Six Pack" (5 Regulations and 1 Directive)
Applies to all 27 MS, with specific sanctioning rules to € area MS	
Strengthening the SGPs fiscal surveillance procedures:	
<ul style="list-style-type: none"> • Reinforcing the Preventive and Corrective Arm (i.e. the EDP applied to the MS that breached the deficit/ debt criteria); • Operationalizing the debt criteria (launching the EDP on the basis of a debt ratio of above 60% of GDP); • Quantitative definition of "significant deviation" from MTO; • Financial sanctions for €-area MS imposed gradually from preventive arm to later stages of EDP; • Enforcing RQMV; 	
Macroeconomic Scoreboard (MIP): New mechanism to identify and correct macroeconomic imbalances.	
(*)	"Two pack" (2 Regulations)
€-area MS only	
Introduce stronger surveillance and assessment mechanism:	
<ul style="list-style-type: none"> • Setting a common budgetary timeline; budget drafts to be presented to the EC before 15th of October; • Common budgetary rules to be monitored by independent institutions 	
January 2013	Fiscal compact
The fiscal section of the TSCG (Treaty on Stability, Coordination and Governance)	
Compliance with budgetary and debt rules; Structural balance of general government should be at MTO or automatic adjustments will be triggered.	

Note: (*) Proposed by the EC in November 2011 and agreed upon on February 2013

What do we have in terms of fiscal union?

ESM/EFSF part of federal budget?

No

Yes

Institutional reasons:
Intergovernmental organisation;
Created ex-post crisis

Economic reasons:
No tax-financed budget

**Resources indirectly covered by
taxpayers**

**Political reasons behind its
creation and use**

**Insurance or burden sharing
mechanism?**

What do we have in terms of fiscal union?

Eurosystem lending part of federal budget?

No

Institutional reasons:
*Distinction between monetary
and fiscal policy*

Economic reasons:
Primary monetary purpose

Yes

As a by-product, mutualized
shocks

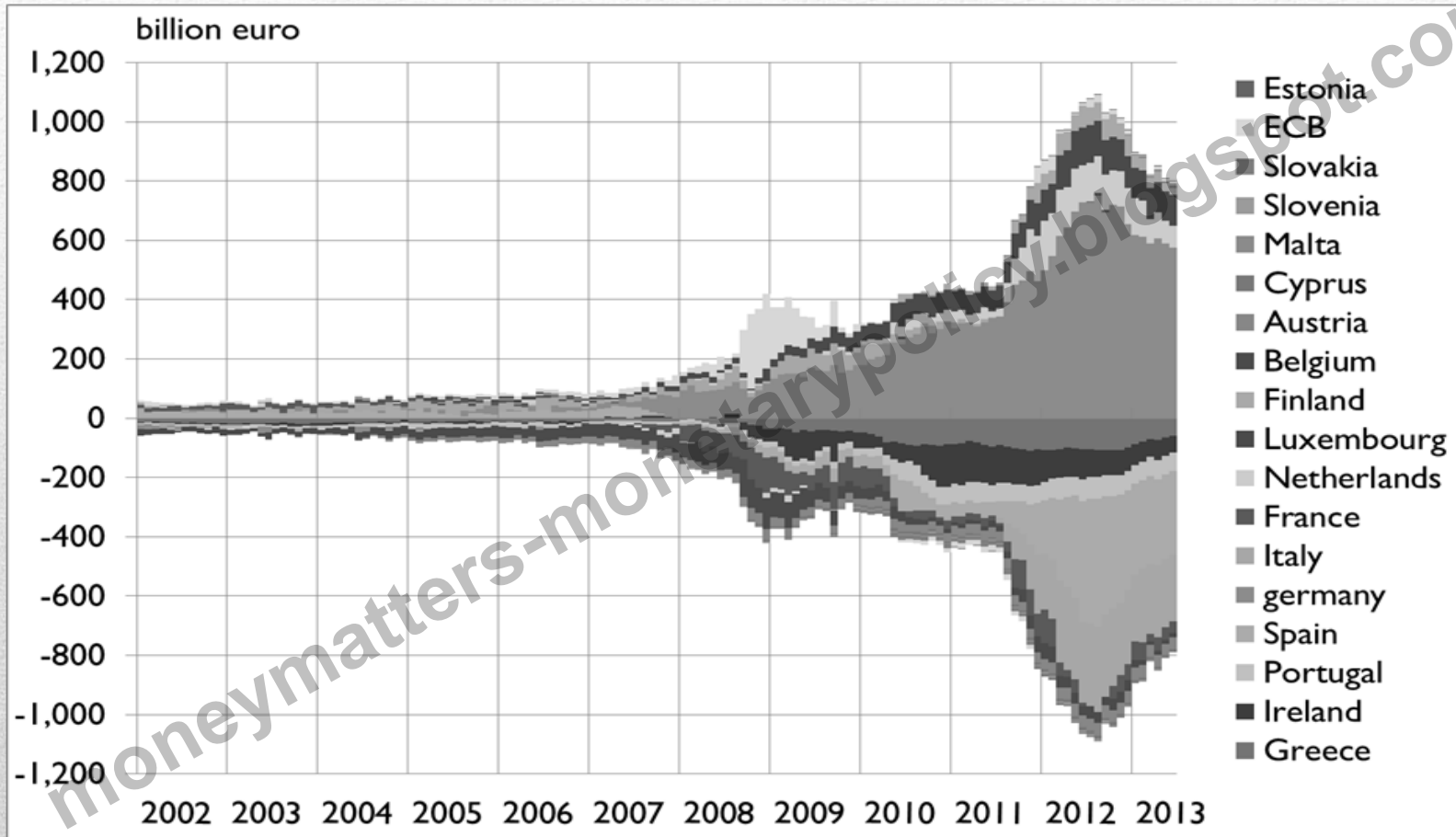
Very large amounts

Implicit transfers

Issuing common debt?

What do we have in terms of fiscal union?

Target 2 balances



Source: P. Cour-Thimann (2013)

What is the gap between what we have and what we need and how do we fill it?

Still a significant gap to be filled especially of institutional nature...

Optimal means of achievement?

Time horizon and sequence?

Macroeconomic stabilization mechanism for the Euro area should:

- *“not lead to unidirectional or permanent transfers;*
- *not undermine incentives for structural reforms;*
- *be implementable within the framework and the institutions of the Union;*
- *not be an additional crisis-solution mechanism, but rather a complement the ESM;*
- *not lead to an overall increase in tax and expenditure levels. “*

[Four Presidents' Report; 2012]

What is the difference between what we have and what we need and how do we fill it?

More control and guidance on national budgets?

EU finance Minister with veto power

Federal budget?

Transfer of cyclical revenue/expense from national budgets to a federal budget

Cyclical Shock Insurance scheme

Ultimate federal backstop for bank recapitalisation

New institutional set-up?

What about Eurobonds?

Strong moral hazard concerns

No need for perfect fiscal union for some form of common issuance

What about political feasibility?

“On-the-brink” theory

Bergsten, Kierkegaard

Conclusions

So far....during the crisis

...progress has been made towards a fiscal union,

...however, insufficient..

Next steps...

...transfer cyclically sensitive expenses and revenues to federal level...

...some progress towards common issuance...

...ultimate federal backstop for banks.

Thank you!

- **My Blog:** <http://moneymatters-monetarypolicy.blogspot.com>
- **My Tweet:** [@FrancescoPapad1](#)